

In this issue

Objectives of NGO Accounting	1
Profit & Loss vs. Income & Expenditure .	1
Profit & Loss Account	1
Income & Expenditure Account.....	1
Audit Statement	2
What about the Balance Sheet?	2
Fund-balances	2
Audit Statement	3
Value-addition	3
Classifying Fund Balances.....	4

Recently, there has been increased interest in NGO accounting and related standards. This paper discusses some of the issues related to setting standards for NGO¹ accounting.

Objectives of NGO Accounting

Why do NGOs maintain accounts? There are several reasons:

- To know how much money they have received and spent in a year. Also to know how much unspent funds they have, and how these are kept.
- To ensure that funds are spent / utilized properly for objectives of the organisation.
- To provide financial reports to donors, Government and public.



Business organisations also maintain accounts for similar reasons. However,

¹ In USA, these organisations are called NPOs or not-for-profit organisations. This helps US organisations to distinguish themselves from the main activity there: profit-making.

On the other hand, in many parts of Asia, these are commonly called NGOs or Non-Governmental Organisations. This perhaps shows how the NGOs have emerged as an alternative to Government action.

there is one very important difference: at the end of each year, owners of the business want to know how much profit² they have made. This helps them decide how much of the profit they can take out as dividend.

This key element is completely missing in NGOs. All NGOs are barred³ from declaring dividends or distributing profits to their 'owners'. This is also clear from the title of the annual financial statements for the two, as discussed below.

Profit & Loss vs. Income & Expenditure

The Balance Sheet is called by the same name for business organisations as well for the NGOs. However, when it comes to the operating statement, the titles are quite different.

Profit & Loss Account

Business organisations prepare a Profit & Loss Account each year. This shows the profit or the loss for the year. As observed earlier, business-people are very interested in this.

Income & Expenditure Account

Following the same reasoning, NGOs should prepare Surplus & Deficit Account. However, this is not the case. NGOs prepare Income & Expenditure Account instead. Why?

² Or loss

³ By their constitution, common practice and the law. NGOs also can not distribute surplus assets to their members on winding up. The term NGO normally does not include co-operative and mutual benefit organisations.

Well, simply because generating a surplus is not the main objective of an NGO. The Income & Expenditure does show a surplus⁴ or deficit. However, this is just like a byproduct.

Most NGO functionaries will not be able to tell you how much surplus or deficit they had last year. On the other hand, businesspersons will be able to rattle off profit figures⁵ for last several years.



Audit Statement

The standard audit report for business organisations also emphasizes this. When commenting on the Profit & Loss Account, the auditors write as follows:

“...in our opinion, the said accounts give a true and fair view:...

ii. in case of the Profit & Loss Account, of the **profit** of the Company, for the year ended on that date.”

Now a question arises: how should the audit report for an NGO be worded? Should we replace the word ‘profit’ with the word ‘surplus’?

⁴ Strictly speaking, this should be called ‘Excess of income over expenditure’. For convenience, we have called it ‘surplus’. The correct title further reinforces the argument, that NGOs are not interested in generating a surplus.

⁵ Not just one figure of profit – business persons have a whole set of figures: gross profit, net profit, cash profit, profit before interest and tax (PBIT), Earnings per share (EPS), profit percentages, graphs, charts, There seems to be a clear case of *philopropy* here!

We could. But NGO functionaries are not really interested in the figure of surplus – it doesn’t have any significance for them. Neither is it relevant for the income tax officer nor for the donors. So why should the focus of the audit be on a figure which is really irrelevant⁶ for NGOs?

An alternative approach for the auditors would be to comment on the amount of the income and the expenditure during the year. The audit report for an NGO may then look as below:

“...in our opinion, the said accounts give a true and fair view:...

ii. in case of the Income & Expenditure Account, of **the income and the expenditure** of the Society, during the year ended on that date.”

What about the Balance Sheet?

At present, there is not much of a difference between the business Balance Sheet and the NGO Balance Sheet. So perhaps the same wording would suffice.

Fund-balances

However, an important element of some NGO Balance Sheets is the existence of ear-marked⁷ funds. Such

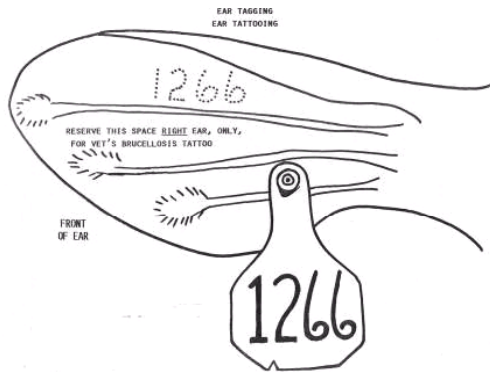
⁶ In fact, profit-making is so irrelevant for NGOs that many prefer to call themselves NPOs (Not-for-Profit Organisations).

⁷ The term ‘ear-marked’ was first used for funds reserved for a specific purpose in the 19th century AD.

This concept came from the ancient practice of marking cattle ears with a tag to indicate ownership. With commercialization of dairy-farming, this callous practice is now finding wider acceptance.

In some countries, the practice was followed for humans also. According to the Holy Bible (Exodus 21), if a Hebrew ser-

funds are set aside for spending on a specific project or in a specific area⁸. These funds are shown on the liabilities side of the Balance Sheet.



In the Balance Sheet shown here, the Tsunami Fund and the Education Fund are ear-marked funds. The Tsunami Fund will be spent on activities related to Tsunami relief or rehabilitation. Similarly, the Education Fund will be spent on education.

The terms Tsunami or education are merely used as short titles. These funds may have been set up by the NGO itself. In such a case, the resolution of the Governing Body will have more details on use of these funds.

Alternatively, these may be from a grant by one or more donors. In such a situation, the agreement with the donor will say what exactly these funds should be used for.

vant did not want to go free after six years, then his Israelite “master shall bring him unto the judges; he shall also bring him to the door, or unto the door post; and his master shall bore his ear through with an [awl]; and he shall serve him for ever.”

⁸ Ear-marked funds can be sub-divided into two categories: 1. Designated funds (set aside by the managing body from NGO’s own funds), and, 2. Restricted funds (restrictions imposed by the donors). For more on the difference between designated and restricted funds, see ‘Technical Guide on Accounting and Auditing in Not-for-Profit Organisations’, ICAI, 2003.

Balance Sheet as at 31-3-05			
Liabilities	Rs.’000	Assets	Rs.’000
General Fund	100	Buildings	70
Tsunami Fund	200	Fund Investments	700
Education Fund	500	Other assets	25
Other liabilities	10	Cash & Bank	15
Total	810	Total	810

Ear-marked funds should be represented by corresponding assets on the Assets side of the Balance Sheet. In the above Balance Sheet, we see fund investments of Rs.700,000 on the assets side. These investments cover the value of both the funds.

Audit Statement

Sometimes this does not happen and the investments⁹ are used up for some other purpose¹⁰. The standard audit report also does not cover this.

Auditors could, therefore, think about modifying the audit report as follows:

“...in our opinion, the said accounts give a true and fair view:

i. in case of the Balance Sheet, of the state of affairs, including the fund-balances and corresponding assets, of the Society as on 31st March 2005.”

Value-addition

This approach could also add more value to audit, so far as the NGO is concerned.

Firstly, it would help the NGO look at fund balances more carefully. NGOs would then be able to set up separate funds, track their value, and monitor

⁹ Against the ear-marked funds

¹⁰ Or there may be a drop in market-value of the investments.

related income and expenditure¹¹. This will help them to plan long-term projects, and nurture resources required to implement these.

Secondly, it would reassure donor agencies that their grant funds are being tracked separately. This would also encourage donor agencies to provide long-term grant funds, secure in the knowledge that the NGO has proper fund-balance tracking procedures.

Classifying Fund Balances

A similar but more complex method of accounting for fund balances is called Fund Accounting in USA. It is popular there, as a large number of NPOs are engaged in raising funds from public. These NPOs often raise funds for specific purposes, such as disaster relief. They also have the discretion to use these funds in various ways, within the broad purposes of the fund.

Accordingly, they set up a self-balancing set of assets, liabilities and fund balance accounts for each Fund¹². They then report on the utilisation and unspent balances from these funds periodically.

For the sake of better understanding, they also classify the various funds as

¹¹ A good example from India is fund-raising with approval under section 35AC of Income Tax Act, 1961. According to the accounting norms under this section, approved NGOs must constantly track the total income, expenditure and balance of the funds raised under 35AC. This can be done quite simply by setting up a fund called 'Project XYZ Fund (35AC)' and following fund-balance accounting procedures.

¹² In some Asian countries, a similar effect is often achieved by keeping a separate cash book and bank account for each project. A separate set of Balance Sheet and Receipts and Payments Account is then prepared for each project.

restricted and un-restricted. In some cases, the funds are classified as Expendable and Non-expendable. The essential principle of the classification is that, the results should strike a chord with the user of financial statements.

Is the US classification relevant for Asia? Not quite. In the Asian environment, it may make more sense to classify funds in a way that would be useful to Asian users. For instance, unspent funds could be classified on the basis



of source as 'Grant Funds' and 'Own Funds'. Or these could be classified on the basis of geography as 'Foreign Funds' and 'Local

Funds'. Another possibility is to classify these as 'Earmarked Funds' and 'Non-earmarked Funds'.

Such classification may not be relevant at all to some Asian NGOs. In such cases, they could continue to follow the natural classification of liabilities as before.

What is AccountAble: Each issue of 'AccountAble' covers a different topic related to NGO regulation or accounting and is mailed to about 2,500 persons in NGOs, Agencies and audit firms. AccountAid encourages reproduction or re-distribution of 'AccountAble' in workshops or NGO newsletters for non-commercial use, provided the source is acknowledged.

Interpretation of law: Interpretation of law given here is of a general nature. Please consult your advisors before taking any important decision.

AccountAble on the Web: All the past issues of 'AccountAble' are available on our web-site www.accountaid.net.

Comments: Your comments and suggestions can be sent to AccountAid India, 55-A, Pocket C, Siddharth Extension, New Delhi-110 014, India; Phone: +91-11-2634 3128, 2634 6111; Fax: +91-11-2634 3852; e-mail: accountaid@vsnl.com.

© AccountAid™ India विक्रम संवत् २०६१ माघ, January 2005 CE.

Printed at Chanakya Mudrak Pvt. Ltd., New Delhi. Ph.: 5142 0316, 2592 3951

For private circulation only.